

Letter of Findings Number: 10-0089
Withholding Tax
For the Years 2006-2008

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ISSUE

I. Withholding Tax—Independent Contractors.

Authority: IC § 6-3-4-8; IC § 6-8.1-5-1; Rev. Rul. 87-41, 1987-1 C.B. 296; IRS Publication 15-A (2010).

Taxpayer protests the imposition of withholding tax.

STATEMENT OF FACTS

Taxpayer is a company doing business in Indiana. The Indiana Department of Revenue ("Department") audited Taxpayer and determined that Taxpayer had not withheld state and county income tax for multiple people determined to be Taxpayer's employees. The Department assessed additional tax with regard to these employees. Taxpayer protested the determination that two of the individuals were Taxpayer's employees (hereinafter referred to as Employee L and Employee V). The Department conducted a hearing regarding the protest and this Letter of Findings results.

I. Withholding Tax—Independent Contractors.

DISCUSSION

Taxpayer protests the imposition of withholding tax with regard to two individuals. Taxpayer claims that the individuals were independent contractors rather than the Department's characterization of the individuals as Taxpayer's employees. Under IC § 6-8.1-5-1(c), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

[IC 6-3-4-8](#)(a) provides:

Except as provided in subsection (d) or (l), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, **who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee**, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department. The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under [IC 6-3.5](#), and on the total amount of exclusions the taxpayer is entitled to under [IC 6-3-1-3.5](#)(a)(3) and [IC 6-3-1-3.5](#)(a)(4). However, the withholding instructions on the adjusted gross income of a nonresident alien (as defined in Section 7701 of the Internal Revenue Code) are to be based on applying not more than one (1) withholding exclusion, regardless of the total number of exclusions that [IC 6-3-1-3.5](#)(a)(3) and [IC 6-3-1-3.5](#)(a)(4) permit the taxpayer to apply on the taxpayer's final return for the taxable year. Such employer making payments of any wages:

(1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and

(2) shall make return of and payment to the department monthly of the amount of tax which under this article and [IC 6-3.5](#) the employer is required to withhold.

The employer requirement to withhold Indiana state and county income taxes derives from the requirement to withhold for federal tax purposes. If an entity is required to withhold federal income tax for an individual because that individual is an employee of the entity—defined either by common law or by statute—the entity is also required to withhold Indiana state and county income tax for that individual as well (assuming the wages are subject to Indiana income tax). Conversely, if an individual is working for the entity as an independent contractor or is exempt from federal income tax withholding by statute, the entity is not required to withhold federal income tax on payments made to the individual.

The Internal Revenue Service has set forth a twenty-part test for determining whether an individual is an employee or an independent contractor. The test, set forth in Rev. Rul. 87-41, 1987-1 C.B. 296, provides for the following twenty factors:

1. **INSTRUCTIONS.** A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the RIGHT to require compliance with instructions. See, for example, Rev. Rul. 68-598, 1968-2 C.B. 464, and Rev. Rul. 66-381, 1966-2 C.B. 449.

2. **TRAINING.** Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods,

indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner. See Rev. Rul. 70-630, 1970-2 C.B. 229.

3. **INTEGRATION.** Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business. See *United States v. Silk*, 331 U.S. 704 (1947), 1947-2 C.B. 167.

4. **SERVICES RENDERED PERSONALLY.** If the Services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results. See Rev. Rul. 55-695, 1955-2 C.B. 410.

5. **HIRING, SUPERVISING, AND PAYING ASSISTANTS.** If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status. Compare Rev. Rul. 63-115, 1963-1 C.B. 178, with Rev. Rul. 55-593 1955-2 C.B. 610.

6. **CONTINUING RELATIONSHIP.** A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. See *United States v. Silk*.

7. **SET HOURS OF WORK.** The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control. See Rev. Rul. 73-591, 1973-2 C.B. 337.

8. **FULL TIME REQUIRED.** If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor on the other hand, is free to work when and for whom he or she chooses. See Rev. Rul. 56-694, 1956-2 C.B. 694.

9. **DOING WORK ON EMPLOYER'S PREMISES.** If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Rev. Rul. 56-660, 1956-2 C.B. 693. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required. See Rev. Rul. 56-694.

10. **ORDER OR SEQUENCE SET.** If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. See Rev. Rul. 56-694.

11. **ORAL OR WRITTEN REPORTS.** A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control. See Rev. Rul. 70-309, 1970-1 C.B. 199, and Rev. Rul. 68-248, 1968-1 C.B. 431.

12. **PAYMENT BY HOUR, WEEK, MONTH.** Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor. See Rev. Rul. 74-389, 1974-2 C.B. 330.

13. **PAYMENT OF BUSINESS AND/OR TRAVELING EXPENSES.** If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities. See Rev. Rul. 55-144, 1955-1 C.B. 483.

14. **FURNISHING OF TOOLS AND MATERIALS.** The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship. See Rev. Rul. 71-524, 1971-2 C.B. 346.

15. **SIGNIFICANT INVESTMENT.** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On

the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. See Rev. Rul. 71-524. Special scrutiny is required with respect to certain types of facilities, such as home offices.

16. **REALIZATION OF PROFIT OR LOSS.** A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. See Rev. Rul. 70-309. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

17. **WORKING FOR MORE THAN ONE FIRM AT A TIME.** If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. See Rev. Rul. 70-572, 1970-2 C.B. 221. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

18. **MAKING SERVICE AVAILABLE TO GENERAL PUBLIC.** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. See Rev. Rul. 56-660.

19. **RIGHT TO DISCHARGE.** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications. Rev. Rul. 75-41, 1975-1 C.B. 323.

20. **RIGHT TO TERMINATE.** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship. See Rev. Rul. 70-309.

These factors supplement the common-law factors determining whether an individual is a common-law employee or independent contractor. See IRS Publication 15-A (2010).

With regard to Employee L, she is a medical typist who is paid by line. She operates from her own home, determines her own hours, and works from her own equipment. Further, she can perform the same services (or has the authority to do so) on behalf of other persons during her work with Taxpayer. After reviewing the appropriate facts, Employee L is properly classified as an independent contractor rather than an employee for federal income tax withholding purposes; therefore, no federal withholding is required on behalf of Employee L. Because no federal withholding is required for such payment, no state withholding is required under IC § 6-3-4-8(a).

With regard to Employee V, while she completes her work from home, provides her own equipment, receives no employee benefits, and has another job, Taxpayer has not rebutted the presumption that Employee V was Taxpayer's employee and thus is denied with regard to Employee V.

FINDING

Taxpayer's protest is sustained with regard to Employee L and denied with regard to Employee V.

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